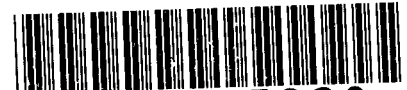


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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA KENNEDY
BOB STUMP

2009 AUG 17 P 4: 04

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY
FOR A HEARING TO DETERMINE THE
FAIR VALUE OF THE UTILITY PROPERTY
OF THE COMPANY FOR RATEMAKING
PURPOSES, TO FIX A JUST AND
REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP
SUCH RETURN.

DOCKET NO. E-01345A-08-0172

**NOTICE OF FILING TESTIMONY
SUMMARIES**

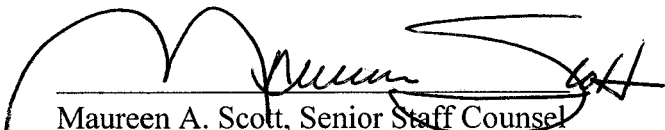
Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony Summaries
of Ralph C. Smith, Elijah O. Abinah and Barbara Keene in the above-referenced matter.

RESPECTFULLY SUBMITTED this 17th day of August, 2009.

Arizona Corporation Commission
DOCKETED

AUG 17 2009

DOCKETED BY



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Original and thirteen (13) copies
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17th day of August, 2009 with:

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**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT
EXECUTIVE SUMMARY
OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

My testimony in support of the Settlement addresses the following sections of the Settlement Agreement:

- III. Rate Increase
- IV. Cost of Capital
- V. Depreciation
- VI. Fuel and Power Supply Adjustment Provisions
- VIII. Equity Infusions to Be Made by APS
- IX. Pension and OPEB Deferrals
- X. Treatment of Schedule 3
- XI. Adjustment of Depreciation Rates for Palo Verde License Extension

A summary of my testimony concerning the Settlement Agreement for each of these areas follows:

III. Rate Increase. For Settlement purposes, Staff, APS, and a number of other parties to this rate case have agreed to a rate increase that would provide APS with approximately \$344.7 million of base rate revenue per year. As shown in the Settlement Agreement, page 13, paragraph 3.8, this \$344.7 million is approximately a 13 percent increase over APS's current revenue of \$2.637 billion. In dollar terms, the base rate increase over APS's current revenue is approximately \$196.3 million, plus \$11.2 million for a fuel related increase in base rates, plus \$137.2 million for the adjusted base cost of fuel related increase. This is also addressed in paragraph 3.2 through 3.6 of the Settlement.

As described in paragraph 3.5 of the Settlement, the parties agreed to an Arizona jurisdictional fair value rate base for the test year ending December 31, 2007, of approximately \$7.666 billion.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT
EXECUTIVE SUMMARY
OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

Settlement paragraph 3.8 shows how the base rate increase provided for in the Settlement compares with various Signatories' initial proposed increases. It has columns for APS's original filing, Staffs direct filing, RUCO's direct filing, AECC's direct filing, and the Settlement. The \$344.7 million total rate increase is below the amounts recommended in APS' and AECC's direct filings, and is above the amounts recommended in Staffs and RUCO's direct filings.

A portion of the base rate increase had already been put into effect when the Commission granted APS an interim increase of \$65.2 million in 2008.

In addition to the amount of base rate increase, the Settlement Agreement also provides for exceptional accounting treatments for APS for Pension and OPEB deferrals (in Section IX), for treating Schedule 3 receipts as revenue (in Section X) and for an adjustment to Palo Verde depreciation rates for a License Extension (in Section XI). Each of these special accounting provisions has future rate consequences for APS ratepayers.

IV. Cost of Capital and Fair Value Rate of Return

The Settlement Agreement at paragraphs 4.1 through 4.3 provides for an overall cost of capital of 8.58 percent and a 6.65 percent fair value rate of return ("FVROR") as shown on Settlement Attachment A. It provides for a return on equity of 11.0 percent, which was the Staff recommendation. The 11.0 percent was at the high end of the range from 9.0 percent to 11.0 percent recommended by Staff witness David Parcell. Staff witness Ernest Johnson's direct testimony, at page 8, explained that Staffs use of the high end of Mr. Parcell's recommended range was intended to aid APS in its efforts to secure access to capital.

Additionally, as explained on page 8 of Staff witness Johnson's direct testimony, as a matter of policy Staff proposed a fair value rate of return (FVROR) that recognized a 1.5 percent return to the difference between Fair Value Rate Base (FVRB) and Original Cost Rate Base (OCRB). This 1.5 percent return was incorporated into the FVROR for Settlement Purposes, as shown on line 9 of Settlement Attachment A. As shown on Attachment RCS-2 to my direct testimony, Schedule A, page 2, column B, line 8, applying this FVROR to the FVRB provided APS with an additional base rate increase of \$51.265 million.

V. Depreciation

Section V of the Settlement Agreement addresses depreciation rates. It provides that APS shall use the depreciation rates contained in Attachment REW-I to APS witness Ronald White's direct testimony, with the exception of Account 370.01, Electronic Meters, for which APS will continue to use the existing depreciation rate of 3.68 percent.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT
EXECUTIVE SUMMARY
OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

VI. Fuel and Power Supply Adjustment Provisions

Section VI of the Settlement Agreement addresses the provisions of the PPFAC that has been agreed to by the parties through the process of negotiation. As provided for in Settlement paragraph 6.1, the 90/10 sharing provision in the current PSA will be continued. The Base Cost of Fuel and Purchased Power is \$0.037571 cents per kWh and shall be reflected in APS' base rates. Gains on SO₂ allowances over or under the normalized jurisdictional test year amount reflected in base rates of \$7.045 million shall be recovered or refunded through the PSA mechanism. The PSA Plan of Administration will be amended to reflect the terms of the Agreement.

VIII. Equity Infusions into APS

As provided in Settlement paragraph 8.1, APS agrees to complete equity infusions of at least \$700 million during the period beginning June 1, 2009 through December 31, 2014. This amount includes the "up to \$400 million" previously authorized by the Commission in Decision No. 70454, which authorization expires on December 31, 2009. Equity infusions are an important component of APS using its best efforts to maintain investment grade financial ratios and a balanced capital structure, and its efforts to improve its existing ratings with the financial rating agency community.

IX. Pension and OPEB Deferrals

Section IX of the Settlement Agreement provides for limited deferrals of Pension and OPEB costs in 2011 and 2012 if such costs exceed the test year level, which the parties to the Settlement Agreement have identified as \$23.949 million. Deferrals of Pension and OPEB costs that occur under such provisions of the Settlement would present an additional cost to APS' ratepayers in a future rate case. Another witness for Staff, Ernest Johnson, is addressing the policy reasons for this treatment.

X. Treatment of Schedule 3

Section X of the Settlement Agreement at paragraph 10.1 provides for APS to record Schedule 3 receipts as revenue during the period January 1, 2010 through the earlier of December 31, 2012 or the conclusion of APS' next general rate case. Currently, APS records Schedule 3 receipts as Contributions in Aid to Construction ("CIAC"). As stated in paragraph 10.2, APS estimated that its Schedule 3 revenues would be \$23 million in 2010, \$25 million in 2011 and \$49 million in 2012. Recording Schedule 3 receipts as revenue, rather than as CIAC, will have consequences for APS' ratepayers in a future rate case. All other things being equal, rate base in a future APS rate case would be higher because of this treatment. Another witness for Staff, Ernest Johnson, is addressing the policy reasons for this treatment.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT
EXECUTIVE SUMMARY
OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

XI. Adjustment to Depreciation Rates for Palo Verde License Extension

Section XI of the Settlement Agreement at paragraph 11.1 provides for APS to record lower depreciation expense on Palo Verde to reflect the impact of a license extension that APS anticipates. APS would implement the lower Palo Verde depreciation rates upon the later date of (1) receiving Nuclear Regulatory Commission ("NRC") approval for the Palo Verde license extension, or (2) January 1, 2012. Attachment B to the Settlement Agreement, at pages 5-6, shows the current and proposed depreciation rates for Nuclear Production, by unit, that APS estimates would result from the Palo Verde license extension.

Paragraph 11.1 also provides that APS shall file a request that the Commission reduce the System Benefit Charge ("SBC") to reflect a corresponding reduction of the decommissioning trust funding obligations collected through the SBC related to the Palo Verde license extension.

As explained in paragraph 11.3, allowing APS to implement new, lower depreciation rates before the Company's base rates for electric service are reestablished in the Company's next rate case is intended to represent a benefit to APS. During that period, the lower recorded depreciation expense amounts mean that Accumulated Depreciation (a rate base offset) would be lower and APS' rate base in the next rate case would be higher.

As with the other aspects of the Settlement Agreement that involved compromises from Staff's normal litigation position on such issues, Staff witness Ernest Johnson is addressing the policy reasons for this treatment in the context of the Settlement Agreement.

**REPLY TESTIMONY IN SUPPORT OF SETTLEMENT
EXECUTIVE SUMMARY
OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

My reply testimony in support of the Settlement addresses accounting and ratemaking issues related to Schedule 3 as provided for in the Settlement Agreement. Staff witnesses Elijah Abinah and Barbara Keene address other non-accounting aspects of Schedule 3.

A summary of my reply testimony concerning the Settlement Agreement for this area follows:

X. Treatment of Schedule 3

After substantial debate and hearings in the last APS base rate case, as well as the last base rate cases for other Arizona electric utilities, including Tucson Electric Power ("TEP") and UNS Electric, the Commission eliminated the free footage allowances for new line extensions that had previously been in place for these electric utilities. The Settlement Agreement at paragraph 10.3 continues to maintain the Commission's current policy regarding payments for line extensions.

Several individuals, many with real estate interests, and a group, Arizonans for Fair Power Policy, have filed testimony in opposition to the Settlement on the basis that they believe the Settlement is not in the public interest unless a free footage allowance for line extensions under APS' Schedule 3 is reinstituted.

The revenue that APS projects it would collect under Schedule 3 is a critical component of the Settlement Agreement, which must be viewed as an integrated document. Specifically, Section X of the Settlement Agreement at paragraph 10.1 provides for APS to record Schedule 3 receipts as revenue during the period January 1, 2010 through the earlier of December 31, 2012 or the conclusion of APS' next general rate case. As stated in paragraph 10.2, APS estimated that its Schedule 3 revenues would be \$23 million in 2010, \$25 million in 2011 and \$49 million in 2012.

The testimony filed by the parties in opposition to the Settlement does not appear to contest or object to the treatment of accounting for Schedule 3 receipts as revenue. Their recommendation to reinstate a free footage allowance for APS would, however, directly impact the amounts that APS has projected it would receive under Schedule 3 as revenue.

The Signatories to the Settlement Agreement have recognized that a change to the Commission's current policy regarding payments for line extensions, such as a modification to Schedule 3 to provide for a free footage allowance, would affect the amount of revenue that APS has projected for revenue from Schedule 3. Paragraph 10.3 provides that, if such a change were to be instituted by the Commission, an offsetting revenue change should also be ordered so that such modifications would be "revenue neutral." Consequently, under this provision of the Settlement Agreement, reinstituting a free footage allowance would mean a higher rate increase for APS' existing customers.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF ERNEST G. JOHNSON
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

Mr. Johnson provides policy level testimony in support of the Settlement Agreement ("Agreement"). Mr. Johnson's testimony summarizes the settlement process, provides reasons which support Staff's conclusions that the Agreement is in the public interest, and addresses several general policy considerations underlying the provisions in the Agreement.

The Agreement's provisions are broken down into the following broad substantive categories:

- II) Rate Case Stability Provisions
- III) Rate Increase
- IV) Cost of Capital
- V) Depreciation
- VI) Fuel and Power Supply Adjustment Provisions
- VII) APS Expense Reduction Commitment
- VIII) Equity Infusions to be Made by APS
- IX) Pension and OPEB Deferrals
- X) Treatment of Schedule 3
- XI) Adjustment of Depreciation Rates for Palo Verde License Extension
- XII) Limit on Recovery of Annual Cash Incentive Compensation for APS Executives
- XIII) Periodic Evaluation
- XIV) Demand Side Management
- XV) Renewable Energy
- XVI) Low Income Programs
- XVII) Revenue Spread
- XVIII) Rate Design
- XIX) Interruptible Rate Schedules and Other Demand Reduction Programs
- XX) Demand Response
- XXI) Other

In addition to Mr. Johnson's testimony highlighting policy considerations underlying the Agreement's provisions, Staff will be presenting three other witnesses who will also be providing testimony in support of the Agreement. Mr. Ralph Smith will address the Agreement from an accounting and revenue requirements perspective. More specifically, his testimony will focus on Sections III, IV, V, VI, VIII, IX, X and XI of the Agreement. Ms. Barbara Keene will address Schedule 3, Renewable Energy, Demand-side Management, and the PSA Plan of Administration. Her testimony covers Sections VI, X, XIV, and XV of the Agreement. Finally,

Mr. Frank Radigan will address the rate design provisions contained in the Agreement, including inclining Block Rate, Time of Use Rates and other rate design changes or other rate schedule matters. His testimony covers Sections XVII and XVIII of the Agreement.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF ERNEST G. JOHNSON
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

The agreed upon provisions in each of these areas were the result of many hours of negotiation and a lot of give and take on the part of all of the parties. The settlement process was open, transparent and inclusive. In the end, while the total rate increase reflected in the Agreement was higher than what Staff had recommended in its Direct Testimony, the increase and other revenue requirement provisions are designed to improve the Company's financial metrics and bond ratings which the Signatories believe will ultimately benefit not only APS but also its customers by allowing the Company to borrow at more attractive rates, and by improving its credit worthiness which should improve its operational flexibility. The provisions are also designed to ensure more predictability and stability in rate case filings by APS over the next few years. In addition, I believe that the Agreement puts the Company on the right path with respect to Arizona's energy future. The Agreement contains a myriad of important commitments by the Company to invest in and make available various renewable energy and demand-side management programs. The Agreement also contains new rate design options designed to move load to off peak hours.

The Agreement also establishes performance measurements that APS must meet in order to recover the costs of increases to executive cash incentive compensation beyond test year levels. The Agreement also contains important reporting requirements and makes provision for a Benchmarking Study whereby APS' performance in a number of areas will be compared to a peer group of companies with similar characteristics.

Finally, the Agreement is in the public interest because of all of the important benefits to customers which I highlight below:

Investment in Arizona's Energy Future.

- Establishment of energy efficiency goals and the creation of tiered performance incentives to encourage meeting those goals;
- At least 100 schools served by DSM programs and at least 1,000 customers in existing homes served by the Home Performance enhanced program element by December 31, 2010;
- Placement of renewable energy projects at Arizona schools and government institutions;
- A plan for utility scale photovoltaic generation and an RFP for in-state wind generation;
- Additional renewable energy projects to be in place by 2015 which, in combination with existing renewable commitments, will result in approximately 10% of APS' retail sales coming from renewable resources; and,
- Construction of one or more renewable energy transmission facilities.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF ERNEST G. JOHNSON
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

Commitments Benefiting Low-Income Customers.

- Continued rate discounts for low income ratepayers, holding these ratepayers harmless from the rate increase;
- Creation of a new bill assistance program to benefit customers whose incomes exceed 150% of the Federal Poverty Income Guidelines but are less than or equal to 200% of the Federal Poverty Income Guidelines, funded by APS; and,
- Waiving additional security deposits for low income ratepayers.

Rate Stability Plan.

- An increase in rate stability, including an extended period without base rate increases and a scheduled plan for future rate cases, resulting in greater administrative efficiency and reduced uncertainty for both APS and ratepayers.

Rate Related Benefits.

- An improvement in APS' ability to attract capital, maintain reliability and sustain growth;
- A limit on recovery through rates in certain circumstances of executive incentive compensation based upon performance;
- A sustained reduction of expenses of at least an average of \$30 million per year over the Plan Term, which will reduce the need for future rate increases;
- An infusion of at least \$700 million of additional equity strengthen APS' bond rating and reduce its future debt costs;
- A plan to be prepared by APS to maintain investment grade financial ratios and improve APS' financial metrics;
- An acceleration of the refund of any potential over-collected amounts in the PSA account, resulting in a lower adjustor rate that would partially offset the base rate increase;
- A reduced Systems Benefits Charge in 2012 if a Palo Verde license extension is approved before the conclusion of the next rate case; and,
- Continued 90/10 sharing of the PSA.

Creation of Performance Measures for APS.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF ERNEST G. JOHNSON
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

New Rate Design Options.

- Creation of an optional super-peak tariff for residential customers and other critical peak pricing rates;
- Twelve month reopening of the E-20 House of Worship tariff;
- Development of Interruptible Rate Schedules and other Demand Response Programs for large customers; and,
- A new optional time of use rate for schools.

The total rate increase reflected in the Agreement is \$344,738,000. This includes a Base Rate Increase of approximately \$131.1 million over the interim rate increase of \$65.2 million, or a total Base Rate Increase of \$196.3 million. The percentage Base Rate Increase, including both the interim increase and the \$11.2 million of revenue associated with establishing new base fuel levels represents a 7.9% increase in base rate revenue. The total rate increase reflected in the Agreement also includes an increase in base fuel costs of \$137.2 million. The total rate increase, including both the Base Rate Increase and the increase in base fuel costs, represents a 13.07% increase in rates. In addition to the Base Rate Increase, various of the Agreement's provisions relating to fuel and purchased power costs, renewable energy, and energy efficiency may have the impact of increasing or decreasing the amounts collected from customers under the Company's various adjustor mechanisms.

The bill impact analysis filed by the Signatories indicates that for a typical residential customer, with average monthly consumption of 1,408 kWh during summer months and 930 kWh for winter months, the increase would be \$8.98 per month in the summer and \$3.67 per month in the winter or an annual average of \$6.332 per month. Estimates of the 2010 DSM Adjustment Clause and the 2010 RES were included in the bill impact analysis for illustrative purposes, but those adjustments will not be implemented at the same time as base rate increases.

My overall recommendation to the Commission is to approve the Agreement because it strikes an appropriate balance between APS' ratepayers and its shareholders, and is in the public interest.

**REPLY TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF ELIJAH O. ABINAH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

My Reply Testimony adopts the testimony filed in by Mr. Ernest Johnson on July 1, 2009, on behalf of the Utilities Division, in support of the Settlement Agreement. I also explain that parties opposing the settlement have raised an issue concerning Schedule 3 that is strictly a policy issue of whether existing customers should pay for growth or should new customers (the cost causers) pay for growth. Staff supports the Settlement Agreement as filed without modifications.

**DIRECT TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF BARBARA KEENE
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

This testimony addresses provisions of the Settlement Agreement, including Power Supply Adjustment Plan of Administration, Treatment of Schedule 3, withdrawal of APS' Impact Fee proposal, withdrawal of APS' System Facilities Charge proposal, revisions to Schedule 3, Demand-side Management, and Renewable Energy.

**REPLY TESTIMONY OF SETTLEMENT AGREEMENT
EXECUTIVE SUMMARY
OF BARBARA KEENE
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172**

This testimony addresses revisions to the Demand-side Management Plan of Administration, the Power Supply Adjustment Plan of Administration; and Service Schedules 1, 3, 4, 5, 8, 10, and 15.